DEPARTMENT OF STATE REVENUE

04-20110618.LOF

Letter of Findings Number: 04-20110618
Use Tax
For Tax Years 2008 and 2010

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ISSUES

I. Use Tax–Recreational Vehicles.

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); Helvering v. Gregory, 69 F.2d 809 (2d Cir. 1934); Comm'r v. Transp. Trading & Terminal Corp., 176 F.2d 570 (2d Cir. 1949); Horn v. Comm'r, 968 F.2d 1229 (D.C. Cir. 1992); Lee v. Comm'r, 155 F.3d 584 (2d Cir. 1998); Indiana Dep't of State Revenue v. AOL, LLC, 2012 WL 892313 Ind., 2012 (Ind. Mar. 16, 2012); Miles, Inc. v. Indiana Dep't of Revenue, 659 N.E.2d 1158 (Ind. Tax Ct. 1995); IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-8.1-5-1; 45 IAC 2.2-3-4.

Taxpayer protests the imposition of use tax on the use of two recreational vehicles.

II. Tax Administration–Negligence Penalty and Interest.

Authority: IC § 6-8.1-10-1; IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of ten percent negligence penalties and interest.

STATEMENT OF FACTS

Taxpayer is an individual and is a resident of Indiana. The Indiana Department of Revenue ("Department") determined that Taxpayer purchased two recreational vehicles ("RVs") in Indiana and other states without paying sales tax in any jurisdiction. As a result, the Department issued proposed assessments for Indiana use tax, ten percent negligence penalty, and interest. Taxpayer protests that one RV ("RV1") was purchased in another state and sales tax was paid to that state at the time of purchase and that the other RV ("RV2") was purchased and titled by a Montana LLC, whose sole member was a revocable trust of which Taxpayer was the trustee, and that no Indiana sales or use tax is due. Taxpayer also protests the imposition of negligence penalty. An administrative hearing was conducted and this Letter of Findings results. It should also be noted that Taxpayer's representative told the Hearing Officer that, in addition to that representative, another attorney would contact the Hearing Officer and provide a Power of Attorney form (POA-1), thereby allowing the Hearing Officer to send a copy of the Letter of Findings to the second attorney. No one ever contacted the Hearing Officer and no POA-1 was provided. Therefore, the Hearing Officer will only send a copy of the Letter of Findings to Taxpayer's first and only authorized representative. Further facts will be supplied as required.

I. Use Tax–Recreational Vehicles.

DISCUSSION

Taxpayer protests the imposition of use tax on the use and storage of two RVs in Indiana. The Department imposed use tax after determining that Taxpayer had been using and storing the RVs in Indiana and that no sales tax had been paid on the purchase of the RVs. Taxpayer protests that RV1 was purchased in Michigan and that sales tax was paid to Michigan at the time of purchase and that RV2 was titled by a Montana LLC and that all legal documents establishing the existence of the LLC were properly filed in Montana. Also, Taxpayer states the sole member of the Montana LLC was a revocable trust which was set up by Taxpayer's wife after the purchase of RV1 and several years prior to the purchase of RV2. Taxpayer explains that his wife passed away prior to the purchase of the second RV and that he was the trustee of his late wife's revocable trust. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The sales tax is imposed by IC § 6-2.5-2-1, which states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

The use tax is imposed under IC § 6-2.5-3-2(a), which states:

(a) An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Also, IC § 6-2.5-3-1 states in relevant parts:

For purposes of this chapter:

(a) "Use" means the exercise of any right or power of ownership over tangible personal property.

(b) "Storage" means the keeping or retention of tangible personal property in Indiana for any purpose except the subsequent use of that property solely outside Indiana.

....

(Emphasis added).

Also, 45 IAC 2.2-3-4 provides:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is acquired in a retail transaction and is stored, used, or consumed in Indiana, Indiana use tax is due if sales tax has not been paid at the point of purchase. The Department determined that Taxpayer purchased the RVs in retail transactions but did not pay sales tax on the purchases. The Department therefore issued proposed assessments for Indiana use tax.

Regarding RV1 (purchased on July 2, 2007, in a state other than Indiana or Montana), Taxpayer was able to provide documentation which establishes that sales tax was paid at the time of purchase. The Department had considered that RV1 was purchased in 2008 and that no sales tax was paid at the time of purchase. However, Taxpayer has established that sales tax was paid in 2007 when RV1 was purchased and that RV1 was a 2008 model. 2008 was therefore the model year, not the purchase year. RV1 was traded in when RV2 was purchased, thereby reducing the amount directly paid for RV2. Taxpayer has met the burden imposed by IC § 6-8.1-5-1(c) of proving the proposed assessment of use tax on the purchase of RV1 wrong.

Regarding RV2 (purchased on November 29, 2010, in a state other than Indiana or Montana), Taxpayer states that Indiana must recognize the Montana LLC under the Full Faith and Credit clause of the federal constitution and that Indiana must therefore follow Montana's and the state of purchase's tax applications. Taxpayer misunderstands Indiana use tax. As explained above, Indiana use tax is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction. Indiana does not question the existence of the Montana LLC. Neither does Indiana question whether or not the Montana LLC was properly formed under Montana law. What Indiana questions is the use of RV2 in Indiana and by whom it is used.

Taxpayer refers to the Indiana Tax Court case Miles, Inc. v. Indiana Dep't of Revenue, 659 N.E.2d 1158, 1163 (Ind. Tax Ct. 1995), which states:

Miles argues that its promotional materials are excepted from use tax under the definition of "storage." "Storage" is defined as "the keeping or retention of tangible personal property in Indiana for any purpose except the subsequent use of that property solely outside Indiana." I.C. 6-2.5-3-1(b) (emphasis added). The Department argues that the promotional materials are taxable under the definition of "use." "Use" is defined as "the exercise of any right or power of ownership over tangible personal property." I.C. 6-2.5-3-1(a). Specifically, the Department contends that "Miles is liable for use tax because its storage of the promotional items in, and withdrawal of them from, its Indiana warehouses constitute the exercise of a right or power of ownership over them."

(Emphasis in original).

The court also added:

Miles is correct. This Court has previously held that the storage exception limits and qualifies the meaning of "use." USAir, Inc. v. Indiana Dep't of State Revenue (1993), Ind.Tax, 623 N.E.2d 466, 470. If property is stored in Indiana for subsequent use outside Indiana, then the activities of storing, handling, and transporting the property cannot be taxed as "uses." Id. To hold otherwise would subsume "storage" within "use," and nullify the exception for subsequent use outside Indiana.

Id. at 1164.

During the administrative hearing, Taxpayer explained that RV2 is used outside Indiana over six months out of the year. Accepting Taxpayer's statement as fact, this means that RV2 was inside Indiana for over five months out of the year. The Miles decision determined that the taxpayer in that case was storing the tangible personal property in question for subsequent use solely outside Indiana. Since Taxpayer used or stored RV2 in Indiana for over five months out of the year, Taxpayer's reference to the Miles decision is misplaced.

In issuing the proposed use tax assessment on RV2, the Department considered that Taxpayer was using RV2 in Indiana without having paid sales tax on the purchase of RV2. On page two of Taxpayer's November 11, 2011 protest letter, under the title "**FACTS RELATING TO OWNERSHIP, PURCHASE, TITILING** *[sic]* **AND USE OF MONTANA LLC'S RV**" (**Emphasis in original**), "Fact" number eight states:

The RV was purchased by the Montana LLC for travel and vacationing primarily outside of the State of Indiana. Its use by this LLC since December, 2010 has been primarily outside the State of Indiana, and to pass through Indiana to get to destinations for vacationing outside the State of Indiana.

As provided by Section 2 of the Montana LLCs Operating Agreement, the "Purpose of the Business" is:

2.1 **General Purpose of the Business.** The Company is primarily involved in the business of investing in real and personal property in Montana and in any other lawful business upon which the Member owning a majority of the company percentages may agree.

(**Emphasis in original**).

Other than the purchase of the RV, Taxpayer was unable to provide any documents establishing any LLC

business or non-business activity at all in Indiana, Montana, or any other state in the union. During the administrative hearing, Taxpayer repeatedly explained that the LLC had no business purpose and did not need one to be a properly formed LLC in Montana. Taxpayer did state that the LLC was formed for the purpose of limiting liability exposure. Beyond this assertion, Taxpayer did not provide any documentation discussing or establishing that liability protection was a motivating factor in the purchase and titling of RV2 by the LLC. Additionally, Taxpayer offered no explanation of how limiting Taxpayer's liability exposure is a business endeavor of the Montana LLC. This is an important question to answer when taking into account that the stated business purpose of the LLC was, "[I]nvesting in real and personal property in Montana and in any other lawful business upon which the Member owning a majority of the company percentages may agree." This is a particularly important question to answer when taking into account the fact that Taxpayer is not himself a member of the LLC. Rather, the revocable trust of which Taxpayer is the trustee is the sole member of the LLC. Taxpayer offered no documentation establishing that the revocable trust agreed to allow the LLC to let Taxpayer use RV2.

Neither did Taxpayer attempt to explain how the LLC used RV2. Rather, the only use discussed was that by Taxpayer. There is no evidence, or even the assertion, that Taxpayer was required to pay the Montana LLC any form of compensation for the use of RV2. Taxpayer did not provide any documentation establishing the terms of use or rental or lease rates for Taxpayer's use of RV2. Instead, Taxpayer wants the Department to accept that the LLC allowed its only asset to be used indefinitely by a non-member (since the revocable trust was the sole member of the LLC and Taxpayer was the Trustee of the revocable trust) without any compensation or explanation of the terms of such use. The lack of such documentation is a strong indicator that liability remoteness was not a factor in the purchase and titling of RV2 by the LLC.

While the LLC made no attempt to undertake any activity beyond the purchase of RV2, the titling of RV2 by the LLC did have a significant impact on the sales tax associated with this purchase. This leads to consideration of the "sham transaction" doctrine, which is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id. at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[T]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id. at 470.

The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Comm'r v. Transp. Trading & Terminal Corp., 176 F.2d 570, 572 (2d Cir. 1949), cert. denied, 338 U.S. 955 (1950). "[T]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Comm'r, 968 F.2d 1229, 1236-7 (D.C. Cir. 1992). In determining whether a business transaction was an economic sham, two factors can be considered; "(1) did the transaction have a reasonable prospect, ex ante, for economic gain (profit), and (2) was the transaction undertaken for a business purpose other than the tax benefits?" Id. at 1237. The question of whether or not a transaction is a sham, for purposes of the doctrine, is primarily a factual one. Lee v. Comm'r, 155 F.3d 584, 586 (2d Cir. 1998).

In this case, the facts are that the officially stated purpose of the LLC's formation was to invest in real and personal property in Montana and in any other lawful business upon which the Member owning a majority of the company percentages may agree, but that the Montana LLC had no business or non-business functions and never attempted to acquire, maintain, or dispose of any property other than the RV in question. In fact, the LLC had no functions of any kind other that those directly related to the purchase of the RV in question. The titling of the RV in Montana, a state without a sales tax, was merely an apparent attempt to reduce or eliminate Taxpayer's sales and use tax liabilities. The formation of the LLC and the titling of the RV in the name of the LLC was therefore a "sham transaction."

Taxpayer argues that the formation of the Montana LLC was not a sham transaction, stating that the LLC was a properly organized legal entity. Taxpayer refers to a 1990 law review article which includes a quote from Judge Learned Hand. That quote provides:

> Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes.
> Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934).

The Department reviewed Helvering v. Gregory and found that in the opinion Judge Learned Hand also wrote:

> We do not indeed agree fully with the way in which the Commissioner treated the transaction; we cannot treat as inoperative the transfer of the Monitor shares by the United Mortgage Corporation, the issue by the Averill Corporation of its own shares to the taxpayer, and her acquisition of the Monitor shares by winding up that company. The Averill Corporation held a juristic personality, whatever the purpose of its organization; the transfer passed title to the Monitor shares and the taxpayer became a shareholder in the transferee. All these steps were real, and their only defect was that they were not what the statute means by a 'reorganization,'

> because the transactions were no part of the conduct of the business of either or both companies; so viewed they were a sham, though all the proceedings had their usual effect. But the result is the same whether the tax be calculated as the Commissioner calculated it, or upon the value of the Averill shares as a dividend, and the only question that can arise is whether the deficiency must be expunged, though right in result, if it was computed by a method, partly wrong. Although this is argued with some warmth, it is plain that the taxpayer may not avoid her just taxes because the reasoning of the assessing officials has not been entirely our own.
>
> Order reversed; deficiency assessed.
>
> (Gregory, 69 F.2d at 811)
>
> (Emphasis added).

Therefore, Taxpayer in the instant case has referred to an opinion which states that the taxpayer in that case took part in a sham and was not allowed to avoid her just taxes. Also, as previously mentioned, the taxpayer in that case appealed to the United States Supreme Court in the case Gregory v. Helvering, 293 U.S. 465, 470 (1935), in which the Court provided:

> In these circumstances, the facts speak for themselves and are susceptible of but one interpretation. The whole undertaking, though conducted according to the terms of subdivision (B), was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.

As provided above, the Supreme Court agreed that the business arrangement was a sham and that the taxes were properly due. Taxpayer's reference to Judge Learned Hand's language does not support Taxpayer's protest. Quite to the contrary, it supports the Department's determination that the purchase of RV2 by the Montana LLC was in fact a sham transaction and that Indiana use tax is properly due.

Taxpayer also provided a copy of a December 27, 2000, Montana Attorney General opinion letter, which was issued to a Montana county attorney. This letter concludes that a certain Montana motor vehicle registration fee is the equivalent of a tax which could not be imposed on tribal members living on reservations or on non-resident active duty military personnel stationed in Montana. Taxpayer believes that this means that tax was paid in Montana and that, as a result, Indiana may not impose use tax.

After review of the opinion letter, it is clear that the Montana Attorney General concludes that the annual motor vehicle registration fee is the equivalent of an annual motor vehicle tax, not of a transactional sales or use tax. Additionally, since it has already been determined that the purchase of RV2 by the LLC constituted a sham transaction and that the Indiana resident purchased RV2, Taxpayer's reference to Montana's registration fees is irrelevant.

Taxpayer also makes the statement that the Department's proposed assessment of use tax in this case would set the standard that any person traveling through or visiting Indiana on a purely temporary basis would be subject to Indiana use tax on any tangible personal property that they bring into the state. The Department takes this opportunity to dispel this notion as obviously erroneous. As the Indiana Supreme Court explained in Indiana Dep't of State Revenue v. AOL, LLC, 2012 WL 892313 Ind., 2012 (Ind. Mar. 16, 2012):

> Indiana imposes both sales and use taxes. The sales tax, also known as the state gross retail tax, applies to retail transactions that occur in Indiana. Ind. Code § 6–2.5–2–1(a) (2010). The use tax applies to storing, using, or consuming in Indiana tangible personal property acquired in a retail transaction regardless of where that transaction occurred or where the retail merchant was located. Ind. Code § 6–2.5–3–2(a) (2010).

These taxes are complementary in the sense that the use tax applies only to transactions that would be subject to the sales tax but escape it, usually because the transaction occurs outside Indiana. Ind. Dep't of State Revenue v. Trump Ind., Inc., 814 N.E.2d 1017 (Ind.2004); see also Ind. Code § 6–2.5–3–4(a) (2010) (exempt from use tax if sales tax paid on acquisition or if otherwise exempt from sales tax); Ind. Code § 6–2.5–3–5 (2010) (allowing credit against use tax for sales, purchase, or use taxes paid in another state). Indeed, the purpose of the use tax is merely to prevent evasion of the sales tax. Belterra Resort, 935 N.E.2d at 177.

The Department in this case determined that an Indiana resident, who is the trustee of a revocable trust which is the sole member of a Montana LLC, used and stored a recreational vehicle (which had been purchased and titled by the Montana LLC) in Indiana for over five months out of the year. Taxpayer provided no documentation to support the assertion of liability remoteness, which was the only non-tax avoidance motivator offered in the protest. The purchase of RV2 clearly meets the standards for the imposition of use tax, as described above in AOL. The Department's application of IC § 6-2.5-3-2 does not expand on the Court's explanation.

In conclusion, Taxpayer has established that sales tax was paid to the state where RV1 was purchased at the time of purchase. However, the purchase and titling of RV2 by the LLC was plainly a sham transaction. Liability remoteness was not a factor in Taxpayer's decision, as trustee of the revocable trust, to have the revocable trust, as the sole member of the Montana LLC, purchase RV2 and title it in Montana and then allow Taxpayer himself to drive RV2, including using and storing it in Indiana for over five months out of the year,

without paying rent or a lease fee and without signing a rental or lease agreement which would establish the terms of such a rental or lease. Taxpayer's references to Montana's registration of the LLC are irrelevant. Consequently, Taxpayer acquired tangible personal property in a retail transaction, used and stored it in Indiana, but did not pay sales tax at the point of purchase or anywhere else. In such circumstances, Indiana use tax is due, as explained by 45 IAC 2.2-3-4.

FINDING

Taxpayer's protest is sustained regarding the imposition of Indiana use tax on RV1. Taxpayer's protest is denied regarding the imposition of Indiana use tax on RV2.

II. Tax Administration–Negligence Penalty and Interest.

DISCUSSION

The Department issued a proposed assessment and the ten percent negligence penalty and interest for the tax years in question. Taxpayer protests the imposition of penalty and interest, stating that he did act reasonably by consulting a Montana attorney and his local attorneys in Indiana. The Department notes that it is not allowed to waive interest, as provided by IC § 6-8.1-10-1(e). The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

. . .

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

. . .

the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

(Emphasis added.)

45 IAC 15-11-2(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, Taxpayer incurred an assessment which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). Taxpayer states that he did act reasonably by asking the Montana attorney if the arrangement was legitimate. The Department is not convinced that it was reasonable for an Indiana resident to expect to purchase a recreational vehicle in a third state via a Montana LLC which had no other functions of any kind and expect to not pay sales or use tax somewhere. Taxpayer has not established that the assessment arose due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c). However, since Taxpayer was able to establish that there was no base use tax due regarding RV1, as discussed in Issue I above, the penalty and interest associated with that purchase are not applicable and will be dismissed. The penalty and interest assessed regarding RV2 are appropriate and will remain as assessed.

FINDING

Taxpayer's protest is sustained regarding RV1. Taxpayer's protest is denied regarding RV2.

SUMMARY

Taxpayer is sustained on Issue I regarding the purchase of RV1. Taxpayer is denied on Issue I regarding the imposition of use tax on the purchase of RV2. Taxpayer is sustained on Issue II regarding imposition of penalty and interest associated with the purchase of RV1. Taxpayer is denied on Issue II regarding imposition of penalty and interest associated with the purchase of RV2.

Posted: 05/30/2012 by Legislative Services Agency
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